Department of the Navy Office of Financial Operations

Presentation on Comptrollers' Responsibilities with Management Controls
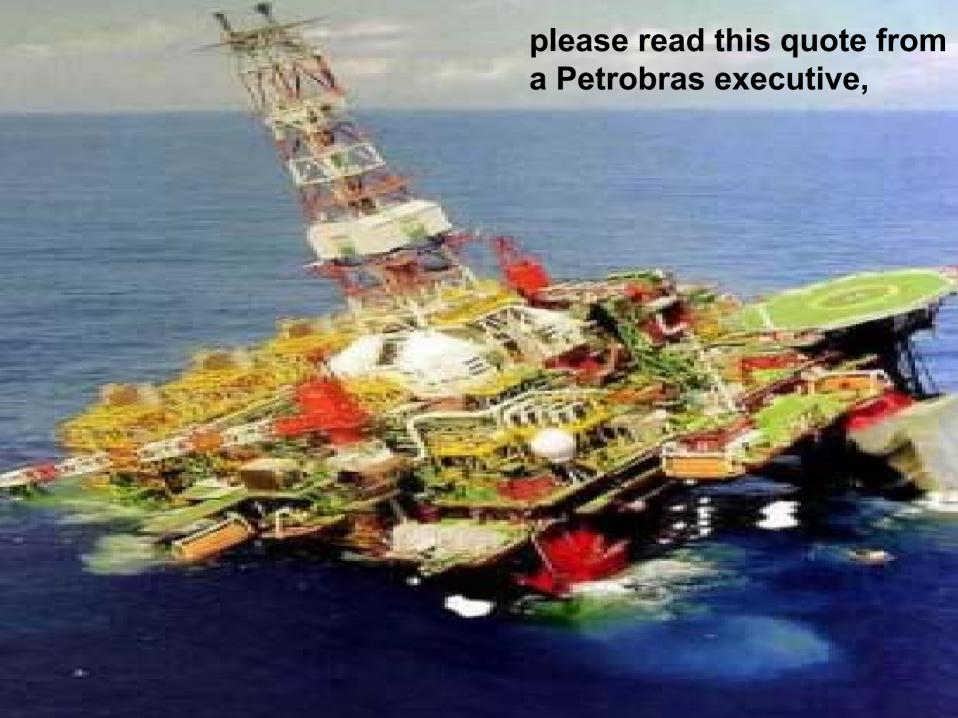
5 March 2002

Agenda

- Consequences of Unmitigated Risks

- Management Controls - Overview

- NAVAUDSVC Efforts

- FMO Back-to-Basics Approach

- Conclusion

QUALITY ASSURANCE AND THE SINKING OF THE LARGEST OFFSHORE OIL PLATFORM

For those of you who may be involved in project cost control (at whatever level),

please read this quote from a Petrobras executive,

extolling the benefits
of cutting quality
assurance and
inspection costs,

on the project that sunk into the Atlantic Ocean off the coast of Brazil in March 2001.

"Petrobras has established new global benchmarks for the generation of exceptional shareholder wealth

through an aggressive and innovative program of cost cutting on its P36 production facility.

Conventional constraints have been successfully challenged

and replaced with new paradigms appropriate to the globalised corporate market place.

Through an integrated network of facilitated workshops,

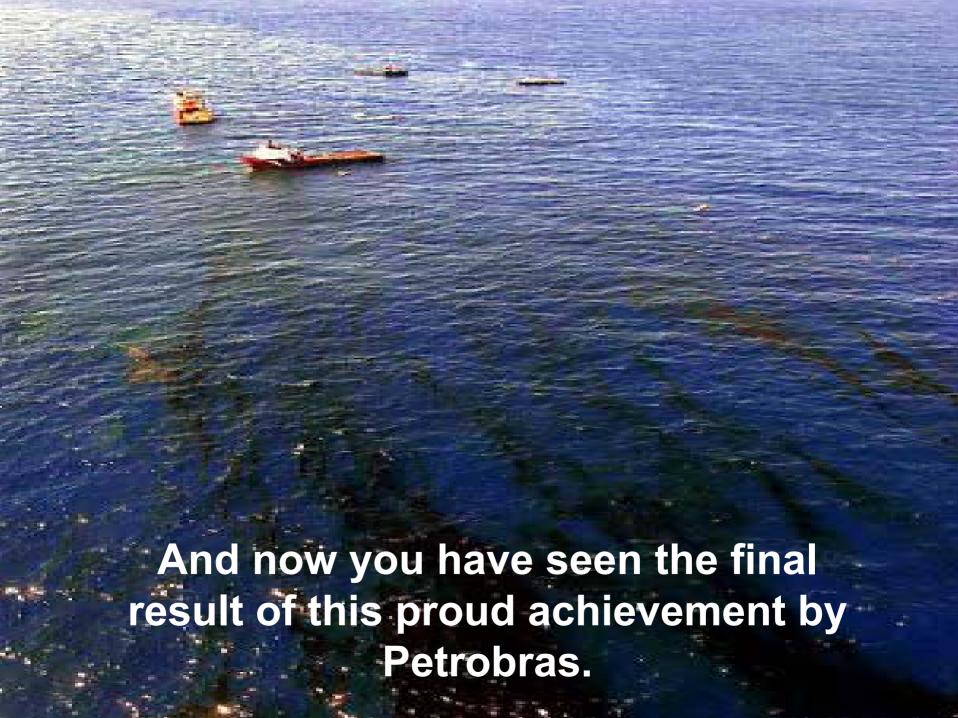the project successfully rejected the established constricting and negative influences of prescriptive engineering,

onerous quality requirements, and
outdated concepts of inspection
and client control.

Elimination of these unnecessary straitjackets has empowered the project's suppliers and contractors to propose highly economical solutions,

with the win-win bonus of enhanced profitability margins for themselves.

The P36 platform shows the shape of things to come

in unregulated global market economy of the 21st Century."

And now you have seen the final result of this proud achievement by Petrobras.

Management Controls in the Federal Government

Why do you need to be concerned with management controls?

- ➢ Insures accomplishment of mission
- ➢ Helps to ensure that resources are protected from fraud, waste, abuse and mismanagement
- ➢ Regulatory/Statutory requirement
  - ✓ FMFIA of 1982
  - ✓ OMB A-123, revised 1995
  - ✓ DoD Directive 5010.38
  - ✓ DoD Instruction 5010.40
  - ✓ SECNAV Instruction 5200.35D

Consequences of Unmitigated Risks Reasons for Control

Dept. of the Navy

Problem Disbursements

Dept. of the Navy

Tailhook scandal

Dept. of the Navy

USS Greeneville Incident

Vermont Farms

Imported Diseased Sheep

(control problems)

Public Demand for Improved Control

Exxon Valdez

Oil Spill

Scandal

Rockwell International

False certification of nuclear waste disposal (compliance problems)

Three-MileIsland

Nuclear reactor meltdown

(compliance problems)

NASA

Challenger Space shuttle

Control problems

Prudential

Deceptive sales practices

Sigma Seafood

Importer Fraud seafood scandal

Ford/Bridgestone/ Firestone

Faulty tires/Ford Explorer rollovers Control problems

Management Controls History

Federal Managers Financial Integrity Act Enacted in 1982

◆ Requires the establishment of "internal accounting and *administrative* controls"

◆ Requires agencies to annually evaluate their systems of internal accounting and administrative control

◆ Requires each agency to prepare a statement of assurance, to include identification of material weaknesses in the agency's systems of internal accounting and administrative control, based on the evaluation of those controls

Management Controls Purpose

Management controls are the organization, policies, and procedures used to reasonably ensure that:

(i)   programs achieve their mission;

(ii)   resources are used consistent with agency mission;

(iii)   programs and resources are protected from waste, fraud, and mismanagement;

(iv)   laws and regulations are followed; and

(v)   reliable and timely information is obtained, maintained, reported and used for decision making.

Source OMB A-123, Revised 1995

Management Controls
GAO Guidance

Control Environment

Key Factors: Integrity and ethical values, organization structure, human capital policies and procedures, etc.

Effective and efficient internal *control activities* help ensure management's directives are carried out. Types of control activities: Performance reviews, segregation of duties, etc.

GAO's Five Standards

Risk Assessment

requires identifying, analyzing, and managing internal and external risks that may affect achievement of an organization's mission.

Information and communication

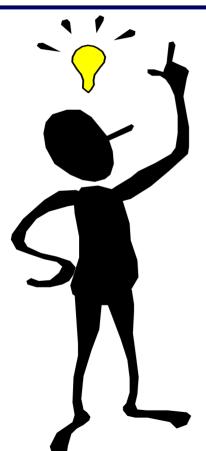should be relevant, reliable, and timely and flow to appropriate personnel.

Internal control *monitoring* should assess the quality of performance over time and ensure audit findings are promptly resolved.

Management Controls
GAO Standards for Internal Controls

Management Control Concepts

- A continuous built-in component of operations
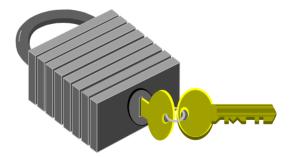
- Effected by people

- Provides reasonable assurance, not absolute assurance
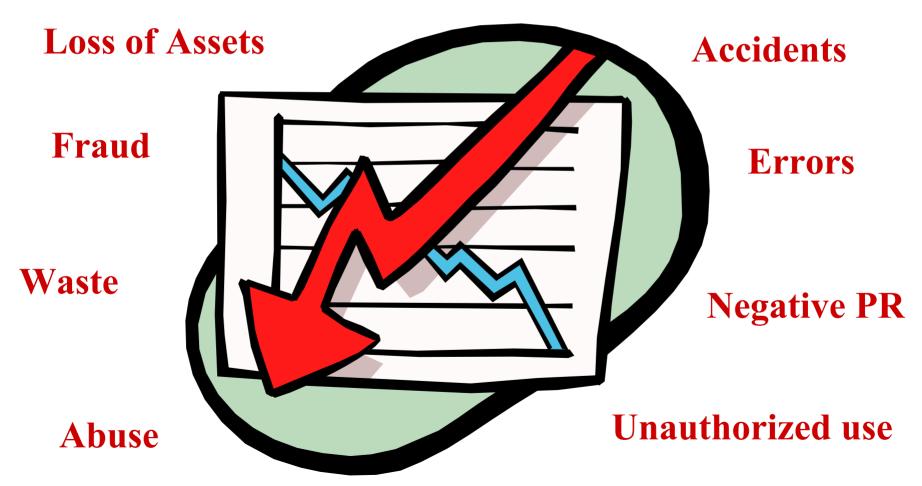
Management Control Examples

- Policies and Procedures
  - Organization Policy Manual

- Segregation of Duties

- Documentation and Record Keeping
  - Staff Meeting Notes

- Performing Reconciliation's:
  - accounting & budgetary records
  - Treasury & appropriation account

- Funds Control

- Placing limitations on obligations & expenditures

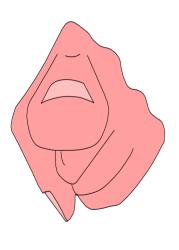- Delegation of Duties
  - Organization Chart

MANAGEMENT CONTROLS ARE THE NORMAL, COMMON SENSE APPROACH TO THE MANAGEMENT AND PROTECTION OF VARIOUS TYPES OF RESOURCES.

When Management Controls Don't Work...

Loss of Assets

Fraud

Waste

Abuse

Accidents

Errors

Negative PR

Unauthorized use

Management Controls Comptrollers Responsibilities

◆ To ensure Revenues and Expenditures applicable to DoD operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports

◆ To maintain accountability over the assets, including nonappropriated funds activities

NAVAUDSVC Audit 2001 Efforts

◆ Objective: To verify that the DON has fully implemented the FMFIA and is meeting the major requirements of the Act.

Reported Impact:

➢ the requirements of the FMFIA, a Public Law, were not met

➢ there was no assurance that the seven activities reviewed had adequate controls in place to preclude material weaknesses
-- CNO   -- Naval IG
-- ASN(FM&C)   -- NCIS
-- ASN(RD&A)   -- OGC
-- ASN(M&RA)

NAVAUDSVC Audit 2001 Recommendations

- Recommendation 1: *Under Secretary of the Navy* provide a memo to Navy commands to stress the need and importance of establishing procedures that are workable and part of management operations

- Recommendation 2: *CNO* establish procedures to periodically monitor subordinate commands to check compliance with FMFIA requirements

- Recommendation 3: *CNO* revise implementing guidance for subordinate activities to establish procedures that meet the intent of FMFIA, are part of management operations and workable at the Echelon 2 and below level.

NAVAUDSVC Audit
2001 Recommendations

◆ <u>Recommendation 3 continued</u>: The guidance should require subordinate activities to include all operational areas at a minimum to:

➢ Require Echelon 2 commands to submit certified annual MCCSs to CNO and maintain supporting documentation for outside review

➢ require that their functional/program managers maintain some form of current information showing their high risk functional areas/processes/programs and show how they tie into the activity's strategic plan

➢ require that their functional/program managers ensure that these high-risk areas are periodically assessed through internal or external assessment tools, such as audits, and document these assessment efforts for outside review

NAVAUDSVC Audit
2001 Recommendations

- **Recommendation 3 continued:**
  - ➢ maintain the required internal tracking system to correct management control weaknesses that are deemed material to the activity management or higher levels
  - ➢ maintain some form of documentation that meets management control plan requirements
  - ➢ incorporate a statement concerning management control responsibilities to meet FMFIA requirements into high-level managers' performance standards
  - ➢ provide high-level managers in all operational areas with FMFIA training

NAVAUDSVC Audit
2001 Recommendations

◆ <u>Recommendation 4</u>: The *ASN(FM&C), ASN(M&RA), ASN(RD&A), Naval IG, OGC,* and *NCIS* comply with FMFIA requirements to include:

➢ Identify and document assessable units

➢ Prepare an annual management control plan

➢ Ensure internal or external management control assessments are performed and documented

➢ Perform training for managers on FMFIA responsibilities

➢ Develop accountability controls to include incorporating FMFIA responsibilities into manager's performance standards

➢ Establish an internal tracking system to ensure management control weaknesses are corrected

NAVAUDSVC Audit 2001 Recommendations

- ◆ <u>Recommendation 5</u>: The Naval IG evaluate activity compliance with FMFIA requirements during inspections, as required by SECNAV Instruction 5200.35D

NAVAUDSVC Audit Lessons Learned

- **Awareness.** Deficiencies in command MCPs are due to a lack of awareness and education on management controls. Organizations have controls in place, and they monitor those controls; however, they may not consider them to be "management controls".

- **Documentation.** DON needs to improve documentation of controls and corresponding MCP efforts.

Back-to-Basics

Back-to-Basics
FMO Efforts

◆ Program focuses on the fundamentals of an MCP

◆ Purpose is to provide tools, strategies, communication venues, training, and processes to all commands to address weaknesses in their existing programs

◆ Approach encompasses:

➢ greater emphasis on training;

➢ assisting commands and activities in enhancing their MCPs through best practices and self assessments;

➢ automating support activities to benefit command and activity operations and to meet the reporting requirements more efficiently and easily; and

➢ establishing an MCP website.

NAVAUDSVC Audit
2002 Follow-on Efforts

Objective - to verify that the Department of the Navy has fully implemented the FMFIA and is meeting the major requirements of the Act. (**Note**: same objective from FY 2001 audit)

- ➢ started end of January 2002

- ➢ auditees were not not identified in Announcement Memo

- ➢ includes follow-up on corrective actions for selected activities reviewed during the FY 2001 Navy Implementation of FMFIA audit

Conclusion

- ◆ Management controls should be an integral part of the entire cycle of planning, budgeting, management, accounting, and auditing;

- ◆ Be aware of the management controls within your organization;

- ◆ Documentation for transactions, management controls, and other significant events must be clear and readily available for examination.

Questions